

# CITY OF SAN JOSÉ

## Future Retirement Costs Study Session

March 29, 2012

# Retirement Information

[www.sanjoseca.gov](http://www.sanjoseca.gov)

- Click on **City Departments** (left column)
- Click on **Employee Relations** (Under City Manager's Office)
- Click on **Retirement Benefits Information**

<http://www.sanjoseca.gov/employeeRelations/RetirementBenefits.asp>

# Agenda

- Retirement Cost Scenarios from Mayor's February 27<sup>th</sup> memorandum as requested by the Rules Committee
- Current Retirement Costs
- Projected Retirement Costs
- Discussion of Volatility/Leveraging

# **Retirement Cost Scenarios from Mayor's February 27<sup>th</sup> memorandum as requested by the Rules Committee**

# Rules Committee Request

- *What would be the impact on the City's retirement costs if:*
  1. *The discount and rate of return assumptions were reduced to so-called risk-free rates pegged to a tax-exempt, 30-year AA or higher-rated municipal bond index, for both pension and OPEB obligations?*
  2. *Increases in medical costs continue at double digit rates for the next 30 years?*
  3. *There is another recession where the plans lose 25% of their market value over two years, followed by a "lost decade" of relatively flat economic growth in which the plans investment return is half of the assumed rate of return?*
  4. *Employee wage increases occur at twice the rate assumed by the retirement boards?*
  5. *All of the above occur?*

# Assumptions

June 2011 Data and Assumptions, except as noted below:

1. Discount Rate changed from 7.5% to 4.0%
2. Healthcare trend rates changed to 10%/year for 30 years followed by valuation assumptions
3. Investment return is:
  - a. -12.5% for 2 years,
  - b. 3.75% for 10 years, and
  - c. 7.5% thereafter

# Assumptions

## 4. Wage Increases:

a. Wage Inflation:	Federated	Police & Fire
2012/13 & 2013/14	+ 6.5	+7.0 (% points)
2014/15 & beyond	No changes	

## b. Other Salary Increases:

2012/13 & 2013/14	Double assumptions
2014/15& beyond	+No changes to assumption

## 5. Combined impact of all of above (where applicable)

# Scenarios as Requested by Rules Committee - Pension

	<b>Current (7.5%)</b>	<b>(1) Risk Free Rate</b>	<b>(3) Recession/ “Lost Decade”</b>	<b>(4) Double Wage Increases</b>	<b>(5) Combined Impact (3) and (4)</b>
<b>Discount Rate:</b>	<b>7.5%</b>	<b>4.0%</b>	<b>Variable</b>	<b>7.5%</b>	<b>Variable</b>
<b>Unfunded Liability</b>					
Police and Fire	\$510M	\$2.112B Inc.	\$2.440B Inc.	\$125M Inc.	\$2.643B Inc.
Federated	\$982M	\$1.737B Inc.	\$2.130B Inc.	\$82M Inc.	\$2.274B Inc.
<b>TOTAL</b>	<b>\$1.492B</b>	<b>\$3.849B Inc.</b>	<b>\$4.570B Inc.</b>	<b>\$207M Inc.</b>	<b>\$4.917B Inc.</b>
<b>Contribution Rate</b>					
Police and Fire	68.9%	114.4% Inc.	81.1% Inc.	9.9% Inc.	92.3% Inc.
Federated	50.2%	60.9% Inc.	39.5% Inc.	4.1% Inc.	44.2% Inc.
<b>City Contribution (\$)</b>					
Police and Fire	\$110.1M	\$186.9M Inc.	\$140.1M Inc.	\$16.5M Inc.	\$158.4M Inc.
Federated	\$106.7M	\$127.3M Inc.	\$85.3M Inc.	\$9.0M Inc.	\$95.1M Inc.
<b>TOTAL</b>	<b>\$216.8M</b>	<b>\$314.2M Inc.</b>	<b>\$225.4M Inc.</b>	<b>\$25.5M Inc.</b>	<b>\$253.5M Inc.</b>

Source: Scenarios prepared by City's actuary, Bartel Associates LLC



# Scenarios as Requested by Rules Committee – Retiree Healthcare

	<b>Current (7.5%)</b>	<b>(1) Risk Free Rate</b>	<b>(3) Recession/ “Lost Decade”</b>	<b>(2) Double Digit Healthcare Trend</b>	<b>(5) Combined Impact (2) and (3)</b>
<b>Discount Rate:</b>	<b>7.5%</b>	<b>4.0%</b>	<b>Variable</b>	<b>7.5%</b>	<b>Variable</b>
<b>Unfunded Liability</b>					
Police and Fire	\$715M	\$559M Inc.	\$36M Inc.	\$665M Inc.	\$732M Inc.
Federated	\$801M	\$679M Inc.	\$82M Inc.	\$876M Inc.	\$1.042B Inc.
<b>TOTAL</b>	<b>\$1.516B</b>	<b>\$1.238B Inc.</b>	<b>\$118M Inc.</b>	<b>\$1.541B Inc.</b>	<b>\$1.774B Inc.</b>
<b>Contribution Rate</b>					
Police and Fire	34.6%	19.7% Inc.	1.3% Inc.	39.3% Inc.	42.8% Inc.
Federated	30.2%	21.0% Inc.	3.0% Inc.	42.2% Inc.	44.1% Inc.
<b>City Contribution (\$)</b>					
Police and Fire	\$34.1M	\$19.4M Inc.	\$1.3M Inc.	\$38.8M Inc.	\$42.2M Inc.
Federated	\$37.2M	\$25.8M Inc.	\$3.7M Inc.	\$51.9M Inc.	\$54.3M Inc.
<b>TOTAL</b>	<b>\$71.3M</b>	<b>\$45.2M Inc.</b>	<b>\$5.0M Inc.</b>	<b>\$90.7M Inc.</b>	<b>\$96.5M Inc.</b>

Source: Scenarios prepared by City’s actuary, Bartel Associates LLC

# Current Retirement Costs

# FISCAL YEAR 2012-2013 RETIREMENT CONTRIBUTIONS

	Police		Fire		Federated	
	City	Employee	City	Employee	City	Employee
<b>Pension</b>						
Normal Cost	33.33%	11.01%	33.59%	11.12%	18.08%	5.74%
Unfunded Liability	23.69%	0.12%	25.30%	0.09%	26.37%	0.00%
<b>Retiree Healthcare</b>	8.96%	8.26%	6.62%	6.11%	7.91%	7.26%
<b>Total</b>	<b>65.98%</b>	<b>19.39%</b>	<b>65.51%</b>	<b>17.32%</b>	<b>52.36%</b>	<b>13.00%</b>
<b>Grand Total</b>	<b>85.37%</b>		<b>82.83%</b>		<b>65.36%</b>	

Source: Cheiron Actuarial Valuation Reports for June 30, 2011

# Unfunded Liability

	<b>Fiscal Year 2011-2012</b>	<b>Fiscal Year 2012-2013</b>
Pension- Federated	\$780.944 M	\$981.56 M
Pension- Police and Fire	\$653.8 M	\$510.3 M
<b>TOTAL PENSION</b>	<b>\$1.435 billion</b>	<b>\$1.492 billion</b>
Retiree Healthcare- Federated	\$681.475 M	\$800.505 M
Retiree Healthcare- Police and Fire	\$627.821 M	\$596.764 M
<b>TOTAL RETIREE HEALTHCARE</b>	<b>\$1.309 billion</b>	<b>\$1.397 billion</b>
<b>GRAND TOTAL</b>	<b>\$2.744 billion</b>	<b>\$2.889 billion</b>

Source: Cheiron Actuarial Valuation Reports for June 30, 2011

# Future Retirement Costs

# Cheiron June 30, 2011 Projections

*Please note that these projections are based on the June 30, 2011 Actuarial Valuations for the Plans, and assume that all assumptions are exactly met since June 30, 2011 and are exactly met each and every year into the future.*

# Cheiron Five-Year Projections- February 2012

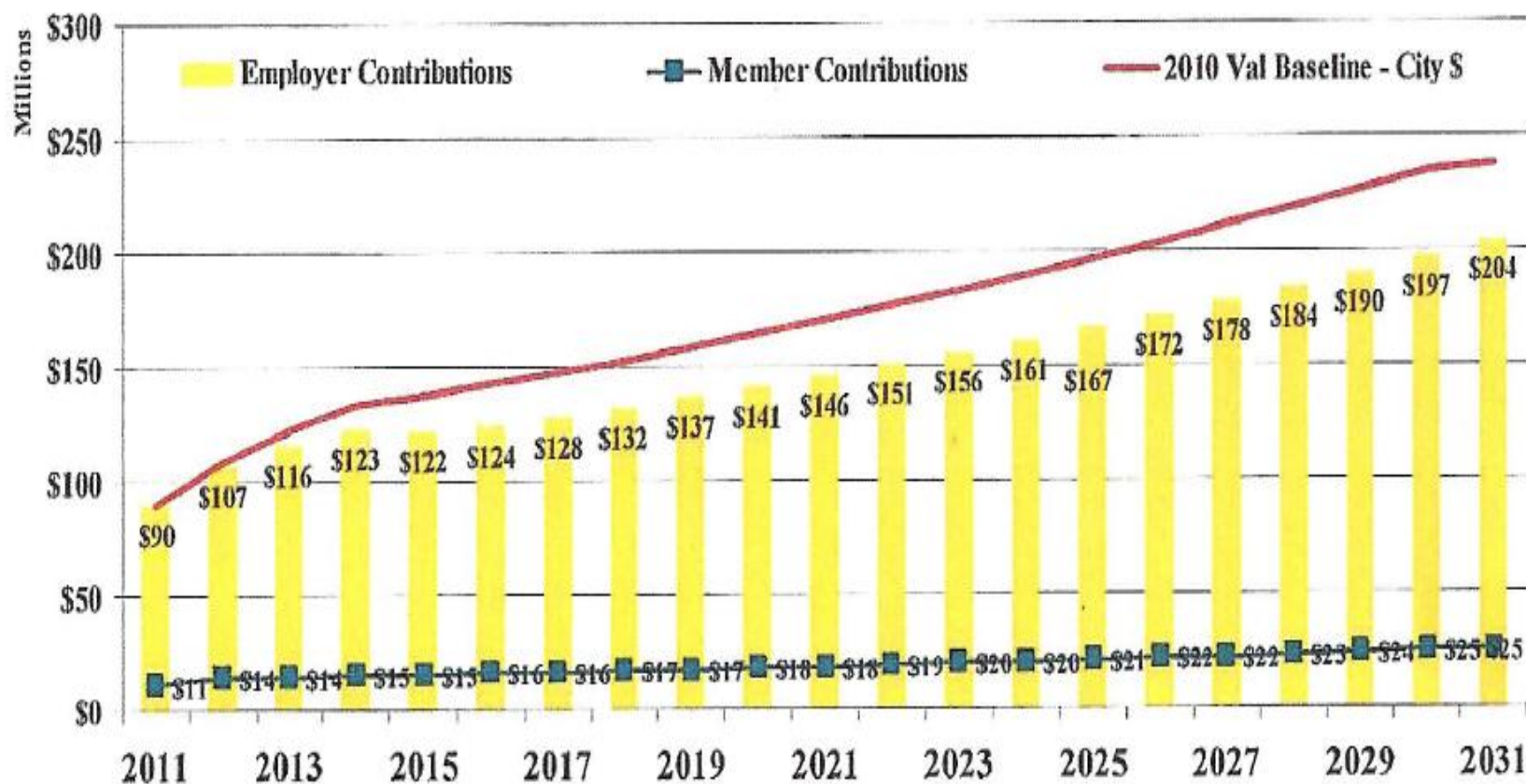
## Pension and Retiree Healthcare

<b>Retirement Plan</b>	<b>FY 12-13</b>	<b>FY 13-14</b>	<b>FY 14-15</b>	<b>FY 15-16</b>	<b>FY 16-17</b>
<b>Federated</b>	<b>\$125.6M</b>	<b>\$158.2M</b>	<b>\$167.4M</b>	<b>\$168.8M</b>	<b>\$171.6M</b>
<b>Police/Fire</b>	<b>\$125.6M</b>	<b>\$140.6M</b>	<b>\$151.6M</b>	<b>\$151.3M</b>	<b>\$153.4M</b>
<b>TOTAL (All Funds)</b>	<b>\$251.2M</b>	<b>\$298.8M</b>	<b>\$319.0M</b>	<b>\$320.1M</b>	<b>\$325.0M</b>

**Source:** Cheiron Five Year Projections Dated February 8, 2012 and February 21, 2012

# Federated Pension 20-Year Projections (Dollars)

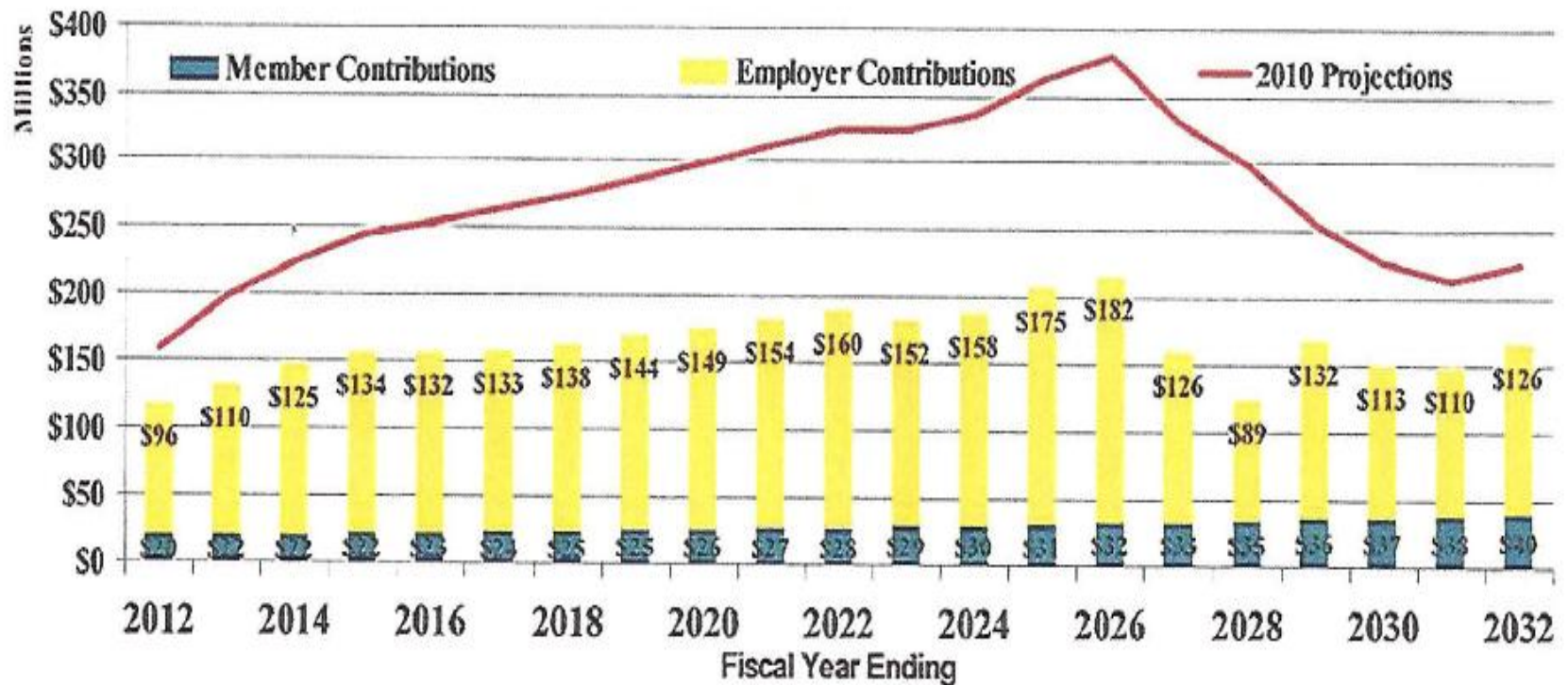
Chart 2: 7.5% return each year – Dollar Contributions





# Police/Fire Pension 20-Year Projections (Dollars)

Chart 2: 7.5% return each year – dollar contribution amounts



# Key Questions:

- How much risk is the City/taxpayers willing to take in defined benefit retirement plans for City employees?
- How confident would the City Council like to be that the cost estimates of the new or revised benefits will be accurate?

<b>25%</b>
<b>50%</b>
<b>75%</b>
<b>100%</b>

# Economic Assumptions

## Investment Return

Expected Distribution of Average Annual Passive Investment Returns	
Percentile	30 Years
5 <sup>th</sup>	11.40%
25 <sup>th</sup>	8.94%
50 <sup>th</sup>	7.26%
75 <sup>th</sup>	5.60%
95 <sup>th</sup>	3.27%

# Discussion of Volatility/Leveraging

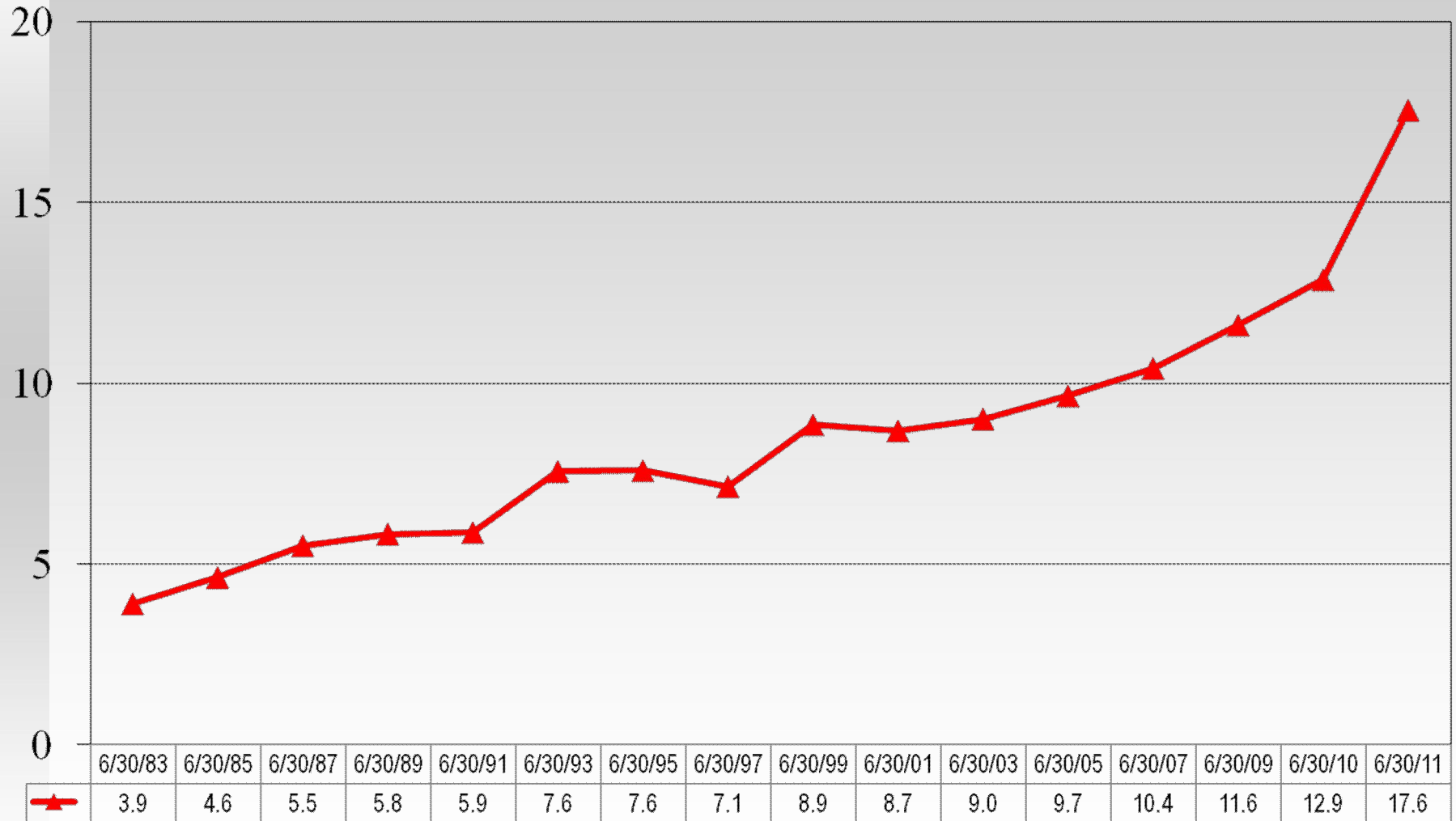
# Volatility/Leveraging

- Contribution rates will continue to be volatile
- Volatility Indicators
  - Ratio of Assets to Payroll
  - Ratio of Liability to Payroll
  - Ratio of Total Liability to Active Liability

Index = 10 and 10% gain  
or loss means  
\$ gain or loss equivalent to one years pay

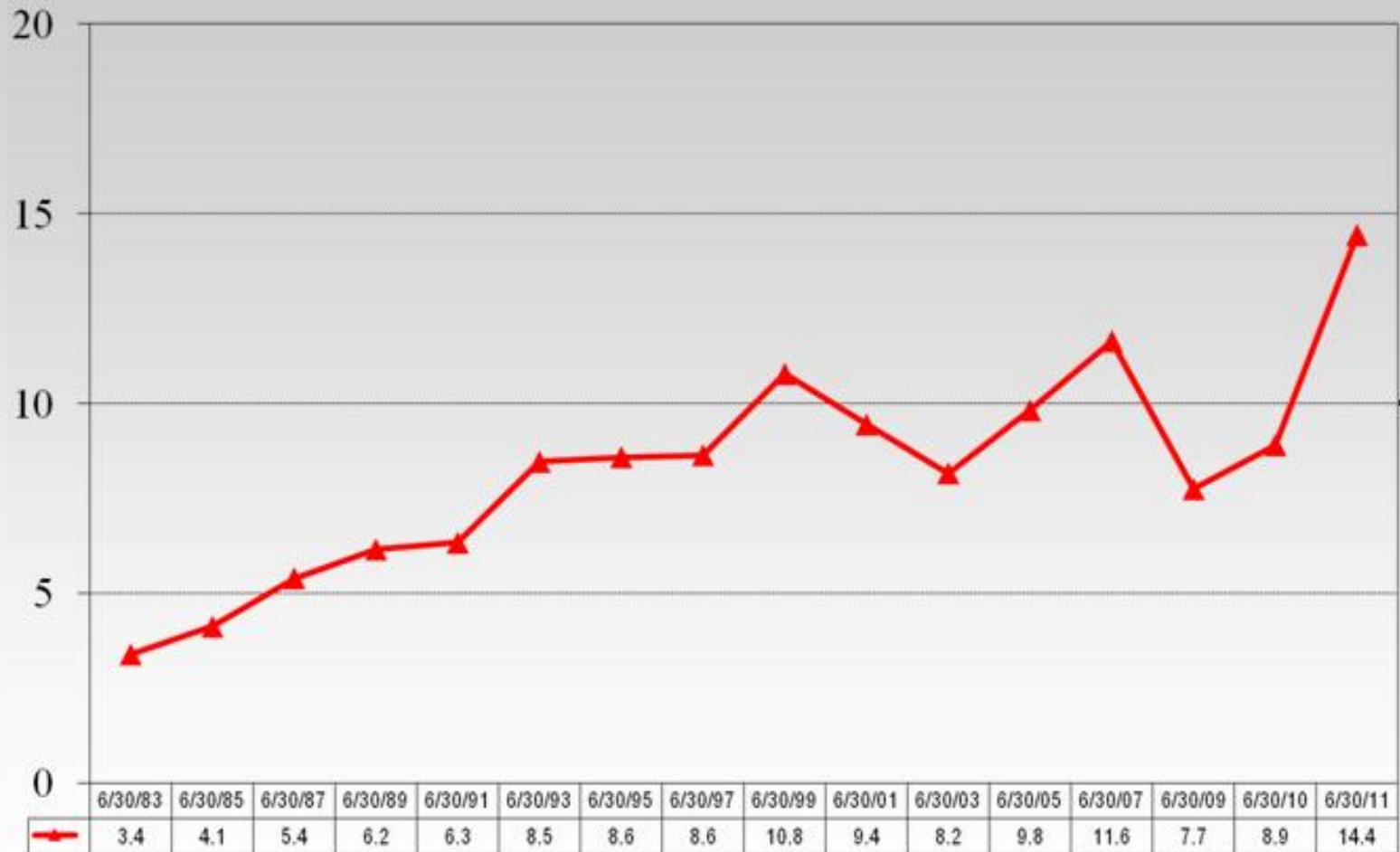
# Police and Fire Department Retirement Plan

## Liability Volatility Index: Ratio of AAL to Payroll



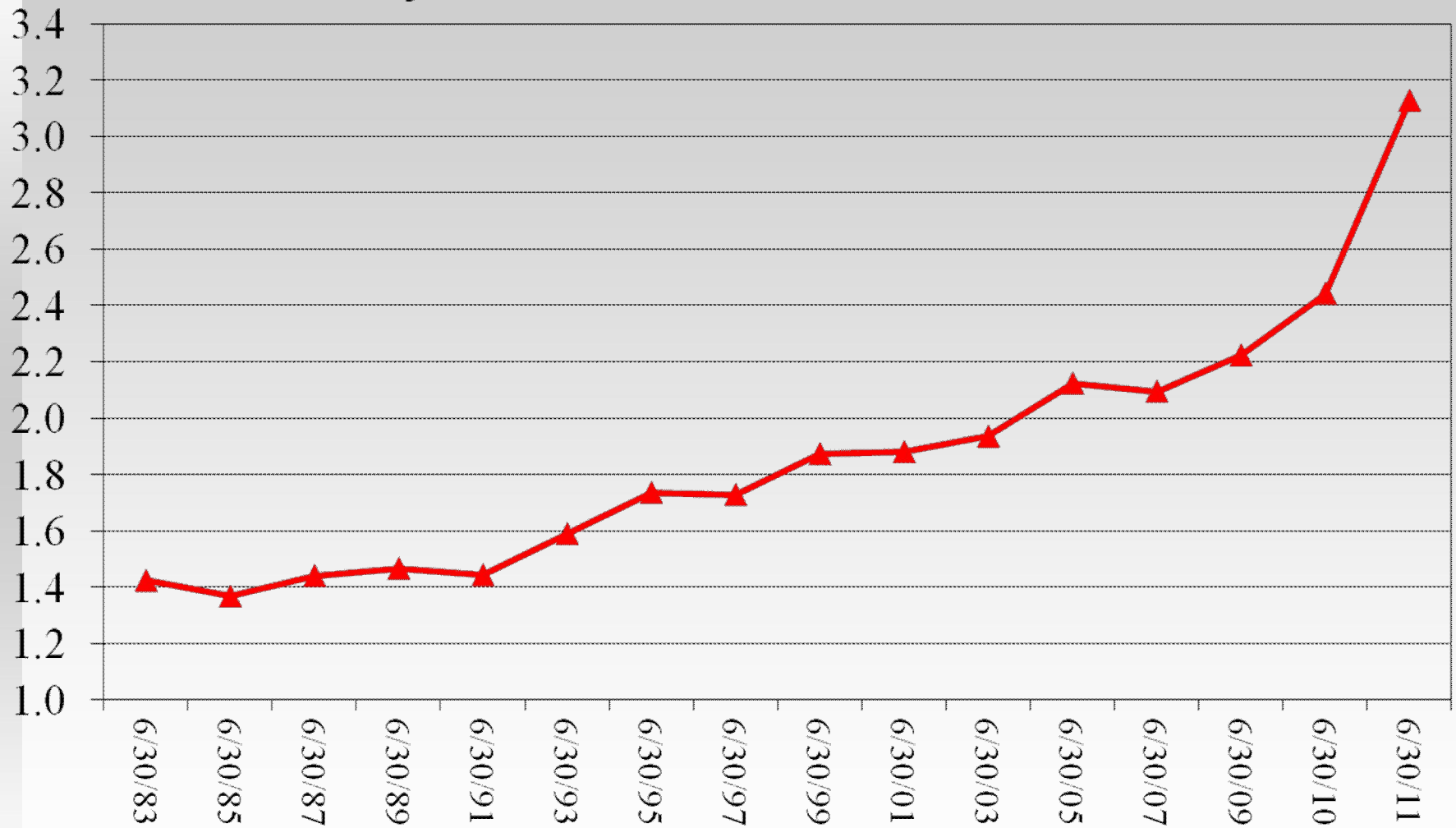
# Police and Fire Department Retirement Plan

## Asset Volatility Index: Ratio of MVA to Payroll



# Police and Fire Department Retirement Plan

Maturity Index: Ratio of total AAL to active AAL





# Example of Leveraging Issue

	<b>Police/Fire (7.5%)</b>	<b>Police/Fire (6.75%)</b>	<b>Federated (7.5%)</b>	<b>Federated (6.75%)</b>
Normal Cost Rate	44.5%	52.6%	23.82%	27.95%
Unfunded Liability Rate	24.4%	35.2%	26.37%	31.67%
<b>Total Contribution Rate</b>	<b>68.9%</b>	<b>87.8%</b>	<b>50.19%</b>	<b>59.62%</b>

# Strategies To Address Volatility

- Plan for volatility in contribution rates
- Request projections in a range
  - Confidence level: 25%, 50% and 75%
- Update projections frequently
- Consider more conservative discount rates
  - Mature systems should not chase investment earnings
- Consider whether investment mix should be less aggressive
- Consider having amortization periods of 20 years or shorter

# Questions/Discussion